

**THE PHILIPPINES RECENT PERFORMANCE,
PROSPECTS FOR 1991-92, AND
POLICY AND DEVELOPMENT ISSUES**

Josef T Yap

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THE PHILIPPINES: RECENT PERFORMANCE,
PROSPECTS FOR 1991-92, AND
POLICY AND DEVELOPMENT ISSUES*

Josef T. Yap**

I. INTRODUCTION

Recent developments have put the Philippine economy at the threshold of another Balance-of-Payments (BOP) crisis. Several months after barely surviving a coup attempt in the latter part of 1989, the Aquino government had its hands full trying to wrestle with a crippling power shortage. Authorities were quick to blame the prevailing drought at that time which already had adverse effects on agricultural production. Just as electricity supply was returning to normal, a disastrous earthquake struck the northern part of Luzon island claiming 1,500 lives and causing much property damage. Then in August, Iraq invaded Kuwait causing the price of oil to double and since that time, domestic fuel prices have more than doubled. As if these were not enough, a secessionist attempt was staged in the island of Mindanao underscoring the disharmony in the armed forces.

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**Research Fellow, Philippine Institute for Development Studies (PIDS).

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Preliminary data on the economic performance in 1990 corroborate the unfavorable nature of the effects of these setbacks. The GNP growth rate fell to a dismal 3.4 percent during the first semester of 1990 after posting an encouraging 5.7 percent growth during the first quarter. ^{1/} Because of the drought, the agriculture sector experienced the biggest slack with a growth rate of 0.17 percent compared to 4.25 percent registered for the same period last year. The peso has depreciated sharply in the third quarter mainly as a result of the ballooning trade deficit which stood at \$1.87 billion as of July 1990 and is expected to reach \$3.8 billion at the end of the year. The government's budget deficit is expected to widen from P20 billion last year to P35 billion in 1990 and, as a consequence, interest rates have shot up to nearly 30 percent with inflation measured on an annual basis posting double-digit figures for more than a year now.

Admittedly, the exogenous shocks have inflicted much damage to the economy. But lest one allows these events to dominate his comprehension of the current state of the economy, one should be reminded that as early as the first semester of 1989, the economy had already been exhibiting signs of deceleration. Table 1 presents some economic indicators for the years 1982, 1983, and 1989 and the period 1986-88 together with preliminary data and projections for 1990. While the 1989 GNP growth rate of 5.67 percent is higher than the average for 1986-88, this figure is still below the government target of 6.5 percent. Moreover, the GNP growth rate in the previous year was 6.74 percent and the prognosis for the economy in 1990, even prior to the December putsch, was 5.5 percent at best.

A major cause of concern is the current account balance. After averaging a surplus equivalent to 0.3 percent of GNP for the period 1986-88, the current account has begun to rapidly deteriorate again, posting a deficit equivalent to 3.3 percent of GNP in 1989. This is expected to reach 6.8 percent in 1990, a figure which ranks behind only the 1982 and 1983 levels which are the highest in the past two decades. Inflation has reached a double-digit figure in 1989 after being contained in the first three years of the Aquino administration. Despite this surge in prices, real interest rates continued to climb steadily, hitting 8.7 percent in 1989 and 10.3 percent during the first three quarters of 1990, after dropping to 5.9 percent in 1988. This reflects the tight monetary policy stance of the Central Bank and the substantial borrowing of the

^{1/}GDP, however, grew by 4.56 percent in the first quarter, down from the year-ago figure of 5.04 percent.

Table 1
BASIC ECONOMIC INDICATORS

	1982	1983	1984-1988 Average	1989	1990 First Sem.	Projection
1. GNP growth rate	1.90	1.11	4.81	5.67	3.40	3.13
GDP growth rate	2.90	0.93	4.13	5.61	2.69	2.47
2. CURBAL/GNP%	8.15	8.87	0.33	3.31	5.31	6.65
3. DEF6/GNP%	7.31	1.96	3.46	2.81	3.61	4.82
4. X% growth rate	(12.25)	(0.32)	15.47	10.56	3.72	3.88
5. Inflation	10.21	10.17	4.43	10.60	12.52	12.78
6. Real interest rate	2.40	4.00	9.10	8.73	10.35	11.46
7. Depreciation rate	8.11	30.13	4.34	3.83	7.48	11.46
8. Debt/GNP%	62.83	72.81	83.82	62.44	-	61.42
9. Terms of trade	0.59	0.61	0.66	0.71	-	-

* Third Quarter 1989-1990

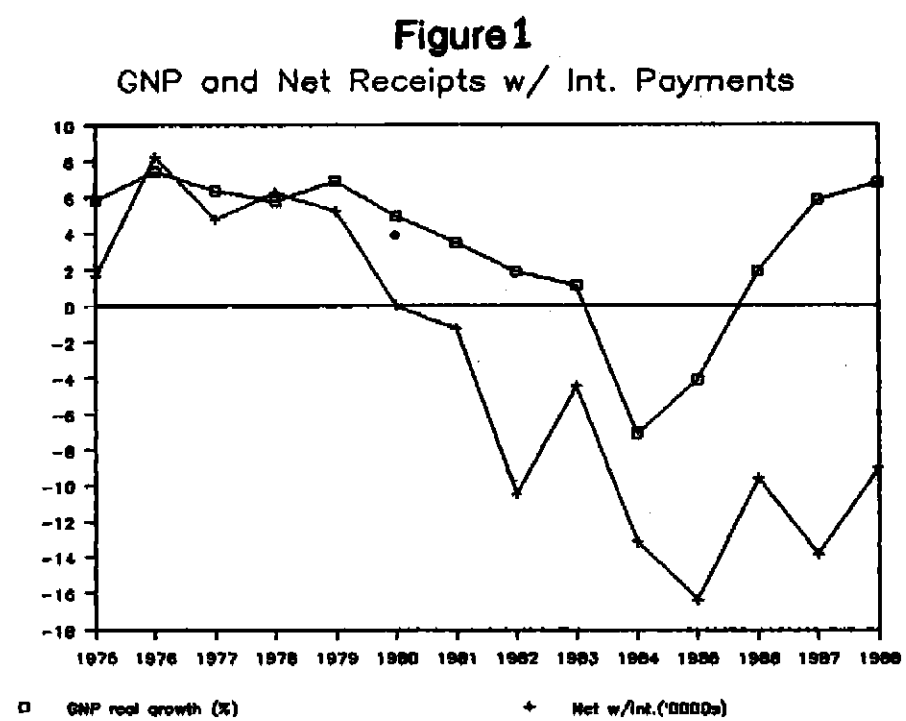
Sources: National Statistical Coordination Board;
Central Bank

government in the domestic market primarily to finance its burgeoning deficit. After posting significant gains in the past with the deficit-GNP ratio falling to 2.0 percent in 1989 after averaging 3.4 percent in 1986-88, the deficit has begun to swell again and is expected to settle at 3.7 percent of GNP in 1990. What makes this prediction even more troubling is that the original target for this year was less than one percent.

Figure 1 should help elaborate the matter of the unsustainability of the recent growth path. The graph shows the close correlation between the GNP growth rate and net capital flows including interest payments on the external debt especially during the period 1979-85. This is evidence of the country's heavy reliance on foreign financing to prop up the economy. During the mid-70s, the economy was experiencing what many economists have described as debt-led growth. After the second oil shock in 1979 and the subsequent recession in the industrialized countries, net flows turned negative and as a consequence, the economy began to lose steam. The effects of past policy decisions began to be felt particularly in the external sector as the traded goods sector could not provide a cushion against this decline. The political turmoil in 1983 only expedited the BOP crisis and the 1984-85 recession.

Despite the continuing net capital outflows, the economy showed signs of recovery in 1986-1989. This has been a result of several factors. First and foremost were the government pump-priming activities which led to a surge in consumer spending. Inflation was contained because of the existing underutilized capacity, a product of the contraction in aggregate demand in 1983-85. Economic reforms, particularly the dismantling of agriculture monopolies which led to higher rural incomes and the import liberalization program which lowered the prices of several commodities, helped fuel this consumption binge. Terms of trade were favorable from 1987-89 mainly due to the drop in oil prices. Exports grew at an average of 14.2 percent, slightly higher than the historical average of 12 percent.

A third factor that aided the recovery was the surge in foreign investment facilitated by the debt conversion schemes being implemented at that time. It is suspected that a considerable portion of the investment coursed through the debt swap mechanisms was returning capital flight. Foreign remittances during this time were also high although this trend had started as early as 1982. A less tangible, albeit equally important, factor was the generally buoyant mood after Ferdinand Marcos left the country. At that time, Corazon Aquino enjoyed widespread support and also wielded a great deal of moral influence.



Sources of Basic Data: National Statistical Coordination Board;
Central Bank; and
Lee and David (1990)

Unfortunately, these conditions which have been favorable to the growth of the economy are no longer present. Excess capacity has been exhausted and as a result, inflation has been rising. Terms of trade have taken a turn for the worse mainly because of the rise in world oil prices. With the current stalemate in the Middle East, there is no immediate relief in sight. Export performance has been sluggish defying the optimism of the trade secretary. With the major industrialized countries on the brink of a recession, foreign investment cannot be relied upon as a major source of external capital flows. Finally, confidence in the ability of the present government to lead this country to NIE status has plummeted resulting in deep fragmentation of the body politic. It may just be this factor that could prove to be the biggest obstacle to economic development.

Thus, not unlike the Aquino assassination in 1983, the recent crises have only served to hasten the decline, exposing the fragile state of the economy. In a sense, we have reverted to the downward sloping portion of the growth curve in Figure 1. Worse, it is evident that we have not outgrown the boom-bust syndrome (De Dios and Bautista 1990) that has plagued the country approximately every 8-10 years since the last world war. The cyclical nature of the BOP crises stems from the inability of all administrations, past and present, to implement fundamental economic reforms.

Even with this rather bleak scenario, it would be difficult to dismiss the Philippines as a basket case. Aside from the obvious potential of the economy in terms of its natural resources and availability of skilled manpower, two more recent developments provide some encouragement. First, even prior to the latest oil crisis, key policy reforms had been approved, although with the advent of the crises, some of these have been derailed. The second piece of encouraging news is that in the aftermath of the earthquake and the jump in oil prices, financial aid from both bilateral and multilateral sources may in fact be stepped up, or at least disbursed more quickly than in the past. ^{2/}

The crucial issue that must be promptly addressed is the availability of foreign finance over the short-term which is necessary in order to prevent a recession similar to 1984-85. Bilateral and multilateral institutions have minced no words in making it clear that such financing is contingent on a number of economic reforms. A genuinely reform-minded government, however, must also be prepared to

^{2/}Quoted heavily from "Asian Economic Commentary (Philippines)," Meryll Lynch, September 1990.

accept lower growth during the initial stages of reform because industrial restructuring and agrarian reform will cause disruptions and necessitate establishment of new institutions (Montes 1990).

It is against this background that this paper would attempt to forecast economic performance in the next two years. In Section II, more details regarding the trends in 1990 are presented. The prospects for the next two years are presented in Section III. Section IV discusses policy debates that have cropped up since 1989 and also analyzes critical development issues for 1991 and 1992. General conclusions are made in the last section.

II. RECENT ECONOMIC PERFORMANCE

A. Economic Growth and Sectoral Performance

A significant deceleration in the growth of the Philippine economy was registered for the first semester of 1990. Real Gross National Product (GNP) posted a 3.4 percent growth, about two percentage points lower than the same period last year. Gross Domestic Product (GDP) posted an increment of 2.7 percent, a much slower growth compared to the concurrent GNP growth and to the GDP growth registered during the same period last year. The slower growth of GDP resulted largely on account of supply side shocks, more important of which were the drought which hit the agricultural sector and power outages which disrupted the industrial sector. Growth in GNP was cushioned somewhat by increased inflows of remittances of overseas workers and by substantial interest payment reductions due to the debt buybacks. However, these were not enough to dispel the negative effects of both political uncertainty engendered by the December 1989 coup and macroeconomic imbalances reflected in higher prices and interest rates. The full effects of such shocks were intensely felt in the second quarter, as aggregate growth slowed down to 1.12 percent from 5.7 percent in the first quarter.

The effects of high prices and interest rates which are reflective of the continuation of macroeconomic imbalances will continue to be felt in the second semester. This is as long as structural reforms and adjustment policies designed to strengthen the domestic economy and improve the country's competitiveness are not enacted. The prospects for such measures remain dim, however, as adverse developments in the second half of the year make such adjustments even more difficult. The damages on infrastructure brought by the July 16 earthquake necessitate additional expenditures on rehabilitation and reconstruction of productive capacity.

The Iraqi invasion of Kuwait on August 2 has led to sharp increases in oil prices, a development which threatens to worsen the slowdown in the world economy. Inflationary pressures have also been heightened as domestic adjustment in petroleum product prices followed the increases in crude oil prices.

Given this scenario, however, full year growth of GNP is expected to remain at 3.1 percent while GDP growth is expected at 2.5 percent. This is on account of the alleviation of the power shortage in the first semester and a slight recovery of the agricultural sector. On the expenditure side, the seasonal second semester increase in consumption expenditures is expected to sustain growth.

Of the components of aggregate demand, it was only total consumption spending which posted a slightly higher growth of 6.0 percent in the first semester, up from 5.7 percent in the same period last year. Much of this is attributed to the accelerated pace of private consumption which grew at 6.2 percent. This was an offshoot of the higher purchasing power brought on by a 39 percent increase in the minimum wage. Increases in consumption were also fueled by inflationary expectations as consumers tried to stock up on basic commodities.

Government consumption posted a decelerated growth of 5.2 percent. Higher compensation indices together with no mandated salary increase for government employees resulted in slower real increases in government consumption. For the year, total consumption is expected to grow by 5.9 percent on account of a 6.1 percent growth for private consumption and a 3.6 percent growth in government consumption. Private consumption expenditures usually kick during the second semester due to holiday spending although such may be lesser as higher prices persist. However, consumption of basic goods may be sustained to the extent that price controls are effective. A slower government consumption growth is expected as economy measures in government operations as contained in Administrative Order No. 177 take effect. These measures include, among others, the suspension of athletic, cultural, sports and public relations activities funded out of agency appropriations, the limitations on the filling up of vacant positions, and the freeze on salary increases.

On the production side, a sharp deceleration in both agricultural and industrial output was registered. From a 4.2 percent growth in the first semester of 1989, agricultural, fishery and forestry growth dropped to 0.2 percent. Industry growth was halved from 6.9 percent in the first half of 1989 to 3.4 percent in this year. Services grew by 3.6 percent, down from the 5.9 percent growth registered last year.

It was the 4.8 percent decline in the value added of the crops subsector which substantially decreased total agricultural production in the first semester. A prolonged dry spell which started in November 1989 brought severe damage to crop production as evidenced by an almost 12 percent decline in the volume of palay production, and about nine percent decline in corn production. The substantial 25 percent increases in palay and corn farmgate prices were not enough to offset the drop in production. Except for coconut and pineapple which posted modest gains, all other major crops posted declines. On a quarterly basis, all the major crops except corn suffered a deceleration in the growth of gross value-added during the second quarter.

These developments have led to massive grain importations for the first semester in order to prevent shortages and upsurges in grain prices. About 600,000 metric tons of rice have already been brought in, nearly thrice the level of rice imports for the whole of 1989. This move was aimed to supplement the buffer stocks of rice which stood at 65 days as of the first semester 1990.

Providing contrast to the crop subsector performance were the robust growth posted by livestock and poultry and fishery subsectors of 10.1 percent and 4.3 percent, respectively. These trends were partly occasioned by a significant appreciation of average unit prices of 19.3 percent for livestock, 13.7 percent for poultry and 4.7 percent for fishery products. Hog, goats, dairy and chicken production all posted accelerated growth relative to comparable figures last year. Commercial and aquaculture fisheries performed well, with the growing demand for seaweed products partly offsetting the decreasing trend in shrimps and prawn production.

The agricultural sector is expected to post a modest 0.6 percent growth for the year. There are indications of a modest recovery in the crops sector as reports of a bumper harvest in corn come in, and as sugar prices remain high. The results of the rice fertilizer subsidy affecting the April and November plantings are expected to be felt starting in the second semester. Livestock and poultry and fishery growth are expected to be sustained.

The manufacturing sector bore the brunt of adverse supply and demand factors which led to a lackluster growth of 2.4 percent for the first semester as compared with the 5.8 percent growth during the same period last year. The five largest subsectors (food manufactures, electrical machinery, footwear and wearing apparel, chemicals and basic metals) registered a low growth of 2.9 percent as against 4.2 percent in 1989.

On the supply side, the frequent power outages especially in the second quarter led to lower petroleum

product consumption of the industrial sector. Despite efforts to minimize brownouts in industrial areas, the brownouts still took a heavy toll as evidenced by the contraction of eleven manufacturing subsectors. Manufacturing firms were also beset by high costs of production as minimum wages increased by 39 percent and as the cost of capital as proxied by the 91-day Treasury Bill rate rose by almost 610 basis points (i.e., from 16.2 percent to 22.3 percent) from the comparable semester last year. Inadequate and unstable supply of raw materials, in particular foodstuffs, also led to decreased production. On the demand side, the downtrend in export demand due to the slowdown in the world economy and the deterioration in the terms of trade also pulled down manufacturing production especially those of manufactured exports such as semi-conductors.

Reversing the 2.2 percent decline posted in the first semester of 1989, the mining and quarrying subsector posted a 1.8 percent increase. The recovery of copper production spurred such increase. From an 8.6 percent drop recorded in the first semester of the previous year, the red metal posted an increase of 2.9 percent. A significant increase of 25.0 percent was also recorded in chromite production, adding impetus to the sector's recovery. However, declining gold prices and consequent decline in gold production prevented the sector from attaining a higher growth rate.

Growth of the construction subsector decelerated from the 15.9 percent registered in the first semester of 1989 to about 7.9 percent this year. High interest rates and the lack of power contributed to the deceleration. This was most felt during the second quarter as private construction slowed down relative to the first quarter. The sustained pace of government construction owing to efforts at accelerating the implementation of infrastructure projects served to maintain public construction growth for the first two quarters.

In spite of the numerous brownouts which occurred during the period, the utilities subsector still managed to grow by 4.5 percent. Gross electric generation increased by 3.4 percent to 737 million barrels of fuel oil equivalent in the first half of 1990. Increasing dependency on oil resulted partly from the drought which reduced electric generation from hydro sources by 14.6 percent.

Continued recovery of the mining and quarrying subsector is expected to boost industrial output to 2.1 percent for the whole year.

Following the overall slowdown of the agriculture and industrial sectors, the service sector grew modestly at 3.6 percent. All subsectors experienced a deceleration in the

expansion. For the whole year, a 4.0 percent growth in services is expected.

B. Employment

Two hundred eighty-six thousand more people were employed domestically in the first seven months of 1990 relative to the same period in 1989. This translated to a marginal decline in the unemployment rate from 8.6 percent in 1989 to 8.5 percent in 1990 first semester. Reflecting the aggregate performance of the sectors, agriculture's share in the total employment declined from 45.2 percent to 44.2 percent while manufacturing's share declined from 10.7 percent to 10.2 percent. Utilities' share in the total employment remained fairly stable while labor absorption by construction increased from 4.1 percent to 4.4 percent. The services sector took up the slack as increments in the share of total employment were posted by wholesale and retail trade, transportation and communication, finance and community and other personal services. As a consequence of the shift toward these services, the underemployment rate for the first seven months increased from 30.2 percent in 1989 to 30.6 percent in 1990.

Indicators for the first five months of the year show an increase in the number of overseas workers by nine percent compared with the same period last year. Of those deployed to the Middle East, the bulk were sent to Saudi Arabia (76.2 percent) while around four percent were bound for Iraq and Kuwait. Foreign exchange remittances from these OCWs increased by 43.5 percent, from US\$357.11 million in 1989 to US\$512.34 this year.

The repatriation of overseas contract workers from the crisis-stricken Middle East and the continued clamor for wage increases point to a worsened employment situation for the rest of the year. The full time equivalent unemployment rate is expected to increase from 19.5 percent in 1989 to 20.4 percent this year.

C. Savings and Investment

A marked slowdown in investment growth was registered during the first semester of 1990. From a robust 27.9 percent growth in the same period last year, investment decelerated to about 3.9 percent. This trend was mainly due to the large drawdown in stocks as the government resorted to its buffer stock of staples to counteract the effects of the drought.

Fixed capital formation growth remained buoyant at 14.2 percent though at a slower pace than last year's 25.6 percent. Durable equipment growth led the way with a 16.4 percent increment. The purchase of power generating

equipment by the National Power Corporation and the acquisition of two transport aircrafts by the Philippine Air Lines powered the growth. Expenditures in public and private construction grew by 11.0 and 12.1 percent, respectively.

On a quarterly basis, a sharp slowdown in investments was evident in the second quarter of 1990. Fixed capital formation decelerated from 22.1 percent in the first quarter to about 6.3 percent in the second, with durable equipment slowing down considerably to a 4.4 percent growth in the second quarter compared with about 31 percent increase in the first.

Both economic and non-economic factors accounted for these trends. On the economic side, the high cost of capital has proven to be a deterrent to further investment growth. Increases in lending rates, following those of average 91-day Treasury Bill rates, have made costs of investments more prohibitive. The same increases in T-bill rates may have caused firms to shift from real assets to these high-yielding, low-risk government securities. Higher costs of inputs, specifically labor inputs on account of higher wages may have undermined firm profitability, thereby leading firms to scale down or postpone expansion plans. The frequent power shortages during the first semester, by increasing wastes and production times, also increased costs and undermined firm profitability. The low level of foreign exchange reserves also constrained the importation of machineries and other durable equipment.

On the non-economic side, local and foreign investor bullishness in the economy was severely shaken by the aborted coup attempt last December 1989. This has led to doubts on the ability of the government to provide a stable and peaceful environment for investments. These fears were translated instantly to reduced interest in the Philippines as an alternative investment site as foreign initial paid-up capital investments grew only by 6.9 percent. Total initial paid-up capital and additional investments grew by 13.5 percent, way below the 80.0 percent registered for the same period last year.

Growth of investments for the whole year is expected at about 1.4 percent. Slower private construction growth of 10.8 percent is expected for the year due to higher cost of inputs and interest rates. A slower full year growth of 16.1 percent for durable equipment is also expected as foreign exchange constraints limit importations. Stocks are not yet expected to normalize as foreign exchange constraints and high crude oil prices limit importation of oil stocks.

D. Budget, Money and Prices

For the first nine months of the year, growth in consumer prices was at 12.5 percent, a deceleration from the first semester rate of 13.0 percent. Higher inflation rates in the first quarter reflected the full effects of measures and events which took place in the latter half of 1989, particularly the increase in minimum wages, the oil price hike on November 30, 1989, and the consequent adjustments in electricity and water rates. The fuel, light and water account thus posted the highest average inflation rate of 23.5 percent for the first nine months. This was followed by the services index whose movements were influenced by the increase in transport fares and tuition fee hikes in schools beginning schoolyear 1990-91. The housing and repairs index likewise posted double digit growth of 14.1 percent as lumber and cement prices and rental rates of houses and apartments increased. Supply bottlenecks due to bad weather conditions as well as distribution problems in Metro Manila following the earthquake occasioned the 10.8 percent increase in the food, beverages and tobacco index.

Full year average inflation is expected to reach 12.8 percent as adjustments in crude oil prices triggered a round of increase in utilities and transport costs. Higher inflation rates are also expected in the latter part of the year due to the 7.5 percent depreciation of the peso for the first nine months which jacked up the prices of imported inputs and consumption goods.

In response to the accelerating inflation in early 1990 and in an effort to meet the March program targets in the MEP, monetary policy in the first quarter was generally contractionary. Increased issuance of treasury bills, increases in the rediscounting rates from 12 percent in June 1989 to 13 percent in February 1990, and an increase in the reserve requirement against deposit liabilities from 20 percent to 21 percent were the measures concretizing this contractionary stance. As a result, the level of domestic liquidity as of end June 1990 represented a mere 3.8 percent increase from the end-December level. Further, base money and money levels declined by about three percent from their end-December levels.

The tight money situation partly explains the increase in average nominal interest rates for the first semester. Rates on Treasury Bills peaked at 25.2 percent in April after the mopping up operations of the Central Bank, but decreased a bit starting in May. The participation of GSIS and SSS in the regular weekly auction of T-bills served to dampen speculation on the rates to a certain degree. This general trend was followed by time deposit rates and secured loan rates.

The latest preliminary data, however, show a sharp increase in Treasury bill rates for the month of September. From the July level of 20.9 percent, the 91-day rate increased to 27.8 percent in August and jumped to 28.3 percent in September. This has brought the simple average of the rates to about 22.9 percent for the first three quarters. The rate increase proceeded as the market reacted to CB pronouncements of tighter money growth due to expected higher inflation rate and the failure of the monetary authorities to meet the prescribed benchmarks for base money in the second and third quarters of the year.

The more fundamental reason for the sharp increases in Treasury Bill rates has been the widening budget deficit of the National Government (NG). Latest data as of September indicate a P32.4 billion deficit, way above the P18.9 billion programmed for the whole year under the December 1989 IMF program. Revenues stood at P125.2 billion while expenditures stood at P157.6 billion.

The factors explaining the widening budget gap could be partly gleaned from the first semester figures. Actual disbursements of the national government for the first semester was five percent in excess of the program. Overspending on interest payments and net lending contributed to the increase. Net lending to corporations remained positive as NG advances to corporations were used to finance required payments for corporate debt papers tendered by the commercial banks. Further, the programmed transfer of about P5.1 billion in CB liabilities to the National Government also contributed to the budget gap.

Aside from the delay in the disbursement of expected inflows, i.e., part of the Economic Support Fund (ESF) which is tied to the implementation of EO 413, the failure to legislate and implement several revenue measures also contributed to the budget gap. Two measures were implemented, i.e., R.A. 6965 which was passed last 18 June 1990 to impose higher excise taxes on cigarettes and liquor and E.O. 399 which was issued on 24 April 1990 to direct cash dividends declared by government-owned or -controlled corporations to be increased from at least five to ten percent. However, several others are on hold. The package of measures whose revenue effects were included in the reckoning of the programmed budget deficit for the whole year include: (a) the gradual phase out of the Gross Receipts Tax (GRT); (b) reduced premium tax on insurance companies; (c) affluent consumption tax; (d) tax on casino gameships; (e) tax on softdrinks; (f) revised taxation of business and professional income; (g) privilege tax on business establishments; (h) tax amnesty on customs duties; (i) incentives to the BIR; and (j) excess energy consumption tax. For the increase in business and professional tax alone, revenue foregone amounted to P2.1 billion. Value added tax collections continue to be low as the lack of

personnel beset the BIR and shortfalls in APT collections were realized.

Efforts of the government to cushion the impact of higher oil prices brought on by the Middle East crisis have had their cost. In shifting from an ad valorem tax base for petroleum products to specific tax base, the rates imposed were not revenue neutral. This meant a loss of almost P6 billion for the national government exacerbating the government's budget woes.

Despite additional expenditure cutting measures in the latter part of the year, the budget deficit is expected to exceed substantially the programmed level. Under performance of trade taxes is also expected as level of imports drop due to foreign exchange constraints. Congress has also sent strong signals that no new tax measures will be legislated. These pressures are expected to contribute to a further widening of the budget gap with the consequent increase in interest rates.

E. External Sector Performance: Exports, Imports, Financial Flows, External Debt and Debt Service

Total exports and imports in real peso terms rose by 7.0 percent and 11.7 percent, respectively. These represent a marked deceleration in their year-ago levels of 14.1 percent for exports and 31.0 percent for imports. Accounting for the sharp deceleration in merchandise export growth from 16.0 percent to a mere 4.2 percent were the slowdowns registered for large volume export items like semi-conductors and electronic microcircuits (4.8 percent, from 20.7 percent), garments (9.3 percent, from 13.2 percent), and copper concentrates (-1.78 percent from 2.7 percent). Viewed on a quarterly basis, declines were actually posted in the second quarter for these export commodities. The problems which have beset the manufacturing sector, i.e., high wages and power outages seem to be more felt with respect to the manufacture of these export items.

On the demand side, the slowdown in export growth can also be attributed to the current deceleration in world economic growth as many of the world's economies have adopted contractionary monetary policies to arrest inflation. First semester US GNP growth, for instance, has tapered to 2.0 percent from 3.2 percent in the same period last year. Decrease in export prices and the continued overvaluation of the peso have also served as disincentives. Further, confidence on the ability of domestic manufacturers to meet delivery deadlines may have been eroded by the unstable political environment following the December 1989 coup, thereby decreasing the inflow of foreign investments in export-oriented industries and reducing the amount of export orders.

Merchandise imports, on the other hand, grew by 13.4 percent which is lower than the 20.7 percent registered during the same period last year. Substantial rice imports raised cereal and cereal products growth to 51.4 percent. Expansion in capital goods imports, particularly those to augment domestic power supply and those to improve telecommunications facilities also contributed to import growth.

Such trends translated to a faster growth of the value of imports relative to that of exports, yielding a trade balance of \$-1873 million in the first semester. This is 62.7 higher than that registered for the same period in 1989. This shortfall, together with lower net inward transfers, served to further widen the current account deficit to \$1229 million from \$767 million last year or from 3.7 percent to about 5.3 percent of GNP.

The trend was registered despite the improvement of the nonmerchandise trade account. Forty one percent growth in personal income reflecting higher inflows of worker remittances and a 6.4 percent reduction in interest payments are the major factors explaining the \$366 million surplus in net nonmerchandise trade account. Lower interest payments came about due to the decline in foreign interest rates and foreign exchange liabilities. The debt buyback program of the government serves to explain the latter.

The surplus of \$262 million for the nonmonetary capital account was also due to effects of the debt buyback schemes. A notable increase in revaluation gains was made due to the discounts realized under the debt cash buyback in January and the operation of other debt reduction schemes. Net inflows of short-term capital increased due to higher net availment of official and development assistance. The net medium and long term loan account weakened as increased loan availments arising from higher inflows from bilateral and multilateral sources and from inflows of new money from foreign commercial banks (\$482 million) were overshadowed by higher loan repayments following the redemption of public sector debt (\$1.34 billion) under the debt buyback operation in January. Net foreign investments also declined as capital withdrawals increased by almost five times and as debt equity conversions were suspended.

The stronger performance of the nonmonetary capital account resulted in balance-of-payments deficit of US\$231 million for the first semester. This was an improvement compared to the \$384 million deficit recorded for the same period last year.

Growth in merchandise exports is expected at 3.8 percent for the whole year. While the substantial depreciation of the peso should boost our competitiveness in

international markets, increases in wages and imported inputs undermine this trend. Even if exporters are given priority in dollar allocations for imports, the still limited foreign exchange hampers the importation of inputs. The destruction brought about by the earthquake to the Baguio Export Processing Zone would seriously impair the ability of semiconductor exports to post higher growth for the rest of the year. Merchandise exports in dollar terms will therefore reach about \$8.06 billion for the whole year.

Import growth is expected to reach 12.8 percent although merchandise imports would achieve slower growth of 13.3 percent. The high price of foreign exchange coupled with its relative scarcity have proven to be effective deterrents. The postponement of the implementation of EO 413, which could have cushioned the impact on import costs due to the tariff reductions therein, also provided a disincentive to import. Merchandise imports are expected to reach \$12.1 billion dollars by year end.

By year end, therefore, the current account deficit would reach about \$3.1 billion or 6.8 percent of GNP. The balance of payments will turn to a deficit of \$873 million.

As of end August, gross international reserves of the Central Bank stood at \$2.1 billion or about 2.0 months worth of imports (based on preliminary July figures). Drawdowns on the second tranche from commercial creditors boosted international reserves.

Total foreign exchange liabilities as of April 1990 stood at \$26,140 million or 5.3 percent drop from the end 1989 level.

International reserves at year end is expected to be at a level equivalent to about 2.1 months worth of imports.

III. PROSPECTS FOR 1991 AND 1992

Economic performance in the next two years largely depends on the manner by which the present economic crisis is resolved. Domestic economic policy and external events will play the major roles with political developments also a significant, albeit unpredictable factor. In a sense, because of the predicament the Philippine economy finds itself in, this study has become less an exercise in projecting numbers than an attempt in predicting the conditions that will yield these numbers.

Section IV will outline the recent moves made by the administration toward economic reform. The recent crisis has caused this program to be derailed and this would

probably be reconciled with an IMF-type macroeconomic policy package. The latter will have as its main objectives the reduction in the current account deficit and the government budget deficit.

The forecasts in this study are conditioned on the following developments that are envisioned to take place in the short-term:

1. The government will "strive mightily through artful liberalization programs, to resolve the internal crisis by raising the foreign financing required." ^{3/} The program will contain the usual conditionalities but not unlike previous experience, this study expects no significant change in the structure of protection.

2. Instead, the first item that will adjust (for reasons to be explained in the next section) would be the exchange rate. Actually, this has already materialized (the exchange rate fell from 25.75 to 28 last 1 November) but some sectors still advocate for a further depreciation of the peso. On a year-to-year basis, a relatively sharp devaluation to the tune of 17-20 percent is expected.

3. Foreign financing will be made available to tide the economy at least over the next year. This implies that there would be no drastic steps toward a unilateral default and the government will continue to meet its obligations on external debt.

4. To reduce the deficit, the government will resort to expenditure-cutting measures and reserve tax increases as a last resort.

5. The military conflict in the Middle East makes it difficult to predict the level of world oil prices in 1991. This study assumes a range of \$25-\$30 per barrel. If the Gulf War is brought to a quick and decisive end by the coalition forces, the price range would surely decline. Prospects of a protracted conflict are too horrible to contemplate.

6. Economic growth in the industrialized countries will slacken.

7. Finally, there is enough reason to believe that the Aquino government will survive the remaining two years of its term. Elections will thus be held as scheduled in 1992. In the unlikely event of a nonconstitutional change in

^{3/}Montes (1990), p. 29.

government, the prospects for the short-term would not be altered considerably, granted of course, that the transition would not be a drawn-out process which is the more probable scenario.

A. Economic Growth and Sectoral Performance

The economy will undergo a period of stabilization and the brunt of effects will be felt in 1991. As a result, growth will continue to be sluggish with GNP posting an increment of 1.8 percent. GDP growth will be slightly higher at 2.2 percent. It should be emphasized that the economy will not experience a tailspin like it did in 1984-85. While the devaluation would cause a sharp increase in prices, it would have beneficial effects on exports and ease the pressure on interest rates. Hence the industry sector, which is usually the hardest hit by a devaluation, would still manage to post a growth of roughly 2.2 percent. The implicit assumption, of course, is that the power situation will be normal. Industrial projects like the CALABARZON and the second phase of the Light Rail Transit system would be additional sources of growth in this sector.

Barring another major drought, the agriculture sector will continue its recovery and register a 2.6 percent growth rate. The more realistic exchange rate should also provide an incentive for increased agricultural production since an overvalued currency has always penalized the agriculture sector in favor of the industry sector. The services sector would follow the trend in both the industrial and agriculture sectors and register a 2.0 percent growth rate.

The jump in prices will discourage consumption expenditures such that the growth in private consumption expenditure will fall to 5.2 percent. Government consumption will decline by 2.8 percent reflecting the continuing austerity programs. Total investment spending will also slow down to 2.3 percent partly as a result of higher crude oil prices. Historical data show that during the two previous oil shocks, the increased fuel bill crowded out importation of machinery and capital goods. Lower interest rates will cushion the drop in investment; in addition, the rehabilitation of the earthquake-ravaged areas will peak in 1991, preventing government construction from dropping off more than .8 percent.

The year 1992 will only be marginally better than 1991. Election spending, which has the potential to be the most expensive presidential campaign in Philippine history will provide the additional boost to economic activity. GNP and GDP growth will be 3.9 and 4.0 percent, respectively. The agriculture sector will continue to lead the way with a 3.2 percent increment. Industry will have sufficiently recovered

and expand by 5.2 percent while the performance of the services sector would continue to be mediocre at a 3.7 percent growth.

Consumer spending will likely be the main beneficiary of election spending. Total consumption will increase by 5.2 percent compared to 4.3 percent in 1991. Following the cue of increased economic activity, investment will likewise post a higher growth rate at 4.9 percent.

B. Employment

Due to the economic slowdown, the full time equivalent unemployment rate will increase both in 1991 and 1992. The projected figures are 22.7 percent and 24.1 percent, respectively. On a sectoral basis, the industrial employment will experience a decrement in 1991 while employment in agriculture will remain constant. Only employment in the services sector will register an increase in 1991. In contrast, all three sectors will employ more workers in 1992. The increase in the unemployment rate can thus be traced to the rise in the labor force participation rate. The continued joblessness of some of the overseas workers from the strife-torn part of the Middle East would also be a contributory factor.

C. Savings and Investment

Despite the decline in the projected investment growth rates, the savings-investment gap is expected to widen. This can be traced to the large devaluation which would lead to an increase in the peso equivalent of net outflows from the country. It is also discouraging to note that the achievement of a 20 percent investment-GDP ratio will be retarded following the adjustment process that the economy must undergo. Last year, it was predicted that the economy would reach this threshold level by 1991.

There should not be much difficulty in filling the gap between domestic savings and investment. Aside from the foreign financing due from creditors, the government is planning to revamp its rules on foreign investment. Projections from the Central Bank indicate that net direct foreign investment will approximate its 1987-88 values in 1991 and 1992. Moreover, studies have shown capital flight (or more broadly, private foreign asset accumulation) to be sensitive to the expected rate of devaluation. A more realistic exchange rate should alleviate the savings-investment gap by encouraging the return of capital flight.

D. Budget, Money and Prices

Inflation will definitely be higher in 1991 than in 1990. Largely because of the expected devaluation, the

inflation rate will jump to 17 percent in 1991. This figure also incorporates a higher wage rate and the December 1990 increase in domestic fuel prices. Inflation should taper off in 1992 but will remain in the double digit level, about 13 percent. Pressure from the budget deficit will hamper the efforts of the country's economic managers to bring inflation below 10 percent. Increased money circulation brought about by the election spending will also push prices in the upward direction.

Discretionary monetary policy will continue to remain tight. The expansion in the monetary base would be mainly due to revaluation effects and losses of the Central Bank on their forward exchange transactions. The real interest rate, however, should be lower as the large devaluation in the exchange rate would eliminate the necessity for indirect Central Bank intervention in the foreign exchange market. Total domestic liquidity is forecasted to grow by 11 percent in 1991 and 17 percent in 1992.

Despite sincere efforts by the government to reduce spending, it still has to contend with the primary source of the bloated deficit, which lies in the mounting interest payments on both domestic and foreign debt. While it is beyond the scope of this paper to recommend measures to deal with this problem, it continues to subscribe to the notion that there is still room to improve current policies designed to deal with the external debt problem.

The budget deficit will continue to be the focal point of policy debate in the next year. No draconian measures to reduce interest payments is expected; hence, the deficit will continue to deteriorate, posting a level equivalent to 3.6 percent of GNP in 1991 and 3.2 percent in 1992.

E. External Sector Performance: Exports, Imports, Financial Flows, External Debt and Debt Service

The sizable devaluation in the exchange rate will generate textbook effects in the external sector - imports will slow down and exports will grow at a slightly faster rate, both variables being measured in real peso terms. The concomitant wage increases and inflation, however, would prevent exports from posting a higher increment. The improvement in the peso current account would be aided by the five percent across the board tax slapped on all imports. With the higher fuel bill, however, the current account deficit will only improve slightly to \$2.6 billion in 1991 from \$3.2 billion in 1990. Unless world crude oil prices will decline, the current account will show no significant contraction although it is expected to dip to \$2.1 billion in 1992.

Based on the assumptions enumerated above, it is expected that the current account deficit would be covered by appropriate movements in the capital account. Since the latter is exogenous in the model used for this exercise, some numbers provided by the government's planning agencies were adopted. The figures indicate substantial inflows from new money and debt rescheduling which, if incorporated in the model, yield a BOP surplus of \$1.3 billion in 1991 and \$1.1 billion in 1992. This is a marked improvement from the projected deficit of \$873 million in 1990.

There will be minimal progress in reducing the external debt overhang. Because of the need for new money to cover the higher oil bill, the external debt will increase in the short-run. The debt-service ratio, however, will hover between 25-30 percent which is still a relatively manageable level. The next administration will be faced with the unenviable task of dealing simultaneously with an external debt which would be roughly equal to the level in 1985 and a public sector domestic debt burden which more than doubled during the period 1985-89.

IV. MAJOR ECONOMIC POLICIES, REFORMS AND DEVELOPMENT ISSUES

With the economy beginning to show signs of faltering, the Cabinet, as early as the second quarter of 1990, initiated a set of socio-economic and financial measures for the remaining years of the Aquino administration (1990-92). The major proponent of this package, current Secretary of Finance Jesus Estanislao, described it as a "new economic program" (henceforth to be referred to as NEP) formulated independent of any IMF influence. While the major thrust of the NEP seems to be consistent with previous reform programs, ^{4/} it is not without its shortcomings. These have been concisely explained in a paper written by a group of faculty members of the University of the Philippines, School of Economics (UPSE). Their basic argument runs as follows:

"To be fair to the issues themselves and to the public, the NEP should explain: first, an analysis of the problems faced; second, the process by which the proposed program is supposed to work; and third, the probable effects these might have on various sectors of society, especially those the program intends to help....Nowhere has a clear framework of analysis been provided that would

^{4/}See for example Alburo, Bautista et al. (1986).

show precisely why and how the specific measures proposed would achieve the aims stated." 5/

One could refer to this document and other recent papers for an analysis of the roots of the present economic malaise. 6/ The subject of this section is simply to present recent policy measures and probable adjustments in the future. Concluding this section would be a discussion of development issues.

A. Trade and Industrial Policy

The centerpiece of the NEP was a set of measures aimed at cutting and streamlining import tariffs. This package evolved into an executive order (EO 413) which was approved by the Cabinet and the President and was actually ready for implementation last September 1990. EO 413, however, has been temporarily shelved following stiff opposition from a group of local businessmen, reflecting the deep-seated protectionist sentiment of the segment that holds power and influence. This policy debate is a throwback to the issue of trade liberalization that has been ongoing since 1974 and the Tariff Reform Program initiated in 1980. Unfortunately, nothing concrete has been resolved and this has not been helped by the haphazard implementation of the import liberalization program (Montes 1989) which was continued in 1986 after being temporarily put on hold during the economic recession in 1983-85. Given the existing economic uncertainty, it is doubtful whether EO 413 will be implemented in full.

Even before the Middle East crisis, the government had intended to deregulate oil prices. This was because the Oil Price Stabilization Fund (OPSF), which has been administered as a subsidy, could not be maintained as such without adverse effects on the budget deficit. This policy proposal was overtaken by events in the Middle East, putting the government in a dilemma. Deregulation of the oil price would have resulted in a quantum leap of fuel prices which would have had dire consequences on the economy especially in terms of social unrest. To work itself out of this quandary, the government stuck to its original plan (i.e., it was part of the NEP) to move away from a strict ad valorem tax on oil to a specific tax which was designed to moderate the increase in fuel prices. The latter have been increased twice over a span of one month but this does not

5/Alonzo, Balisacan et al. (1990), p. 2.

6/See also Dohner and Intal (1989), Montes (1990), Montes (1989), and also de Dios (1984). The latter focuses on the 1983-85 BOP crisis although much of the analysis is still relevant today.

seem to be enough as oil companies have requested an additional increase.

In order to attract more foreign investment, the administration is contemplating amendments on rules governing this area. These include a relaxation of ownership requirements and a redirection of the role of the Board of Investments towards investment and trade promotion away from its present allocative function.

B. Financial Policies and Reforms

The NEP contains major reforms that have been proposed for the financial sector. If implemented immediately, these would have a positive impact on the economy especially in terms of savings mobilization. Among these are:

- Delineation of rules on liberalizing bank entry in order to foster competition in the banking industry;
- Abolition of the five percent gross receipts tax and 20 percent withholding tax on interbank deposits as a means of further reducing financial intermediation costs; and
- Lowering of required reserves over time and the phasing out of the agri-agra requirement.

In April 1990, the Central Bank liberalized its rules on new banks and bank branching activities although there are reports that bankers still find these restrictive.

C. Monetary Policy and Exchange Rate Policy

Recent economic discussions have focused on two matters that need to be addressed with the utmost urgency: the mounting public debts and the trade and current account deficits. These twin macroeconomic imbalances could be attributed to flaws in policies implemented during the Aquino administration.

The Central Bank has regularly intervened in the foreign exchange market in order to prop up the value of the peso. This resulted in a currency overvaluation making importation more attractive and discouraging exports. The ballooning trade deficit mitigated the Central Bank's ability to effectively intervene leading to a sharp depreciation of the peso in the third quarter of 1990. The NEP actually stipulates that the Central Bank will maintain a flexible exchange rate policy designed to make the Philippine industry more competitive, a policy which, however, does not deviate significantly from past pronouncements.

Monetary policy has been tight since 1983 owing to the obsession of the Central Bank to control inflation. As a result, the real rate of interest, together with the reserve requirement ratio, has remained at very high levels. The high interest rate policy of the Central Bank is also aimed at easing pressure on the peso by keeping asset-holders from shifting from pesos into dollars.

The NEP recognizes the detrimental effects of high interest rates on the economy especially investment activities. The NEP mandates that: 7/

"We will go beyond the traditional over-reliance on monetary tools, i.e., to squeeze down monetary supply, to tolerate high interest rates, and to allow economic growth to decelerate. Instead, we will allow for a steady moderate growth of money supply, and to stay within the monetary growth track, and to prevent slippages from such a track to build up. This is the environment within which we can undertake initiatives to bring down the structures of our interest rates."

This proposed monetary rule, however, still has to be specified.

D. Public Sector Reforms

Interest payments on foreign and domestic debt have been the chief reasons behind the widening government deficit. The NEP recognizes this aspect when it categorically states that "domestic debt service reduction must be undertaken with as much determination as foreign debt reduction" 8/ although it remains "enigmatically silent on the foreign debt issue." 9/ Moreover, the strategy to reduce domestic debt service is not clearly specified.

High interest payments on domestic debt follow from the high interest rates that have persisted after the 1983-85 recession. Following a model of Cohen (1987), this policy

7/As stated in the 15 June 1990 memorandum of Secretary Estanislao to the President on the "Strategic Approach to Implementation of our Socio-economic and Financial Measures, 1990-92."

8/"Report on General Agreements: Special Cabinet Meeting," Business Star, 2 June 1990.

9/Alonzo, Balisacan et al. (1990), p. 4.

option was intended to contain the trade balance in lieu of a sharp devaluation. The latter alternative has been eschewed by the Central Bank primarily to enable the government to meet its external debt obligations and also to minimize its losses on forward exchange cover transactions. Within the context of the first reason, the Central Bank has essentially substituted domestic debt for foreign debt. 10/

Another interesting and controversial development has been the transfer of fiscal related liabilities in the books of the Central Bank to the national government. This has also contributed to the increase in the 1990 deficit of the national government. The move has generated controversy because of the explanation behind the transfer. The Central Bank argues that these liabilities properly belong to the national government, that they were a result of fiscal-related measures. The faculty members of UPSE, however, have pointed out that these losses arose from inappropriate monetary and exchange-rate policies. First, there are the losses on forward cover operations borne by the Central Bank; and second, the deficits have also arisen from the high interest cost of the "Jobo" bills, which were issued in 1984-85 to mop up excess liquidity and to curb inflation. 11/

In order to narrow the deficit, the executive branch of government has opted for the easier path by proposing an increase in taxes and a similar increase in rates on services provided by government-owned and -controlled corporations (e.g., National Power Corporation). The former strategy has been opposed by the Congress which instead advocates for a cut in expenditures. At the present time, there has been no agreement on the actual deficit cutting measures. A strategy to increase taxes leaves much to be desired in view of the relatively low levels of the tax effort ratio which implies that there is still much room to increase revenues by way of stricter implementation of existing tax measures. As for the increase in utility rates, the GOCCs could instead focus on greater efficiency in their operations (for example, increase their collection effort) not to mention the inflationary impact of the former strategy.

On the other hand, a cut in expenditures will surely be met with stiff resistance especially from cause-oriented

10/The theme of Reaganomics was essentially "Buy Now, Pay Later." Perhaps the motto of the CB during the term of Jobo Fernandez was "Pay Foreign Debt Now and Domestic Debt Later." The problem is that "later" came sooner than was expected.

11/Alonzo, Balisacan et al. (1990), p. 10.

groups which invariably bring the issue of huge external debt payments into the picture. Another disadvantage of this option is that a disproportionate share of the reduction in expenditures would likely fall on maintenance and operating costs. This would accelerate the depreciation of infrastructure facilities which are already in an unsatisfactory state.

This paper ends this part by assessing the future of the NEP. Given the existing economic problems and the depletion of the country's foreign exchange reserves, this policy package will probably be reconciled with an IMF-type macroeconomic program. The first thing to give would likely be the exchange rate since a devaluation would hit several birds with one stone. Imports will decline, the pressure on interest rates will be reduced, and there will be a positive effect on exports. Of course, the government will have to contend with the inflationary consequences although it would make things less difficult if the devaluation were a one-shot deal. A watered-down version of EO 413 would be approved which essentially means that the protectionist structure will remain as is. Things could be different though come the GATT negotiations in the Uruguay Round.

The financial measures would most likely be implemented in toto. With the devaluation, monetary policy could be relaxed somewhat; hence, the reason for the decline in real interest rates. The government deficit would still be the thorniest issue since it is intertwined with the matter of external debt obligations. Probably as a last resort, taxes would have to be raised. As for the matter of a unilateral default, such a move will probably not arise after the government receives guarantees of new money at subsidized rates.

E. Development Issues

Last year, the need for structural reform as the single most important issue that faces the Philippine economy was cited (Yap 1990). Despite the varying circumstances due to the crises that hit the country, this proposition remains fixed. Some sectors see the need for an immediate stabilization program in order to tame the twin deficits. While one cannot argue with this objective, it must be noted that the net capital outflows that have existed since 1980 have contributed to both the current account deficit and the government's deficit. Structural reforms would also include the correction of past policy mistakes that partly accounted for these macroeconomic imbalances. Within a milieu of continuing net resource outflows, however, it would be virtually impossible to carry out structural reforms. The dangers of subscribing fully to IMF-type prescriptions lie in the social unrest that this will foment. The nationwide

strike last 24 October 1990 may only be the tip of the iceberg and the intensity of the next backlash is anybody's guess.

A more satisfactory debt package is thus a prerequisite for implementing any type of reform, rendering moot the need for a stabilization program. Moreover, it is important to be cognizant of the possible microeconomic responses to these reforms since this would spell the difference between success and failure of the adjustment programs (Montes 1989). This translates into the need for an industrialization policy that is anchored on a sound science and technology development program. The benefits that businessmen could derive from such a reform package should perhaps be clarified in order to lessen any skepticism that they may harbor.

While the exigency for structural reform remains a constant, the nature of the reforms may be affected by changes in the global economic environment. There is a tendency to define economic efficiency along the lines of an "export-oriented" economy. Such a proclivity would definitely be modified if the parameters of the international financial system would shift. Economic globalization is giving way to regionalized trading blocs which tend to complement rather than conflict with the existing world trading system. This configuration would diminish the chances of a country obtaining a mandate to install its currency as an international unit of account and subsequently mismanaging this privilege. While the development of this type of international financial system is at its incipient stage, it would most likely advance at a very rapid rate.

It would therefore be a wise move for policymakers to anticipate the "revolution" that will occur in the global economy and conceptualize the structural reforms along this line.

V. CONCLUSION

Notwithstanding the political and nonpolitical crises that hit the country - referring to the events described in the first paragraph of this paper - four years of procrastination has made the bitter pill of economic reform more difficult to swallow. A year ago in this forum, this writer warned of the danger of a principle of simply "muddling through" which, if pursued, would cause policymakers to be overtaken by reality. To the credit of the Aquino administration, it did initiate moves toward more fundamental reform. Despite its drawbacks, the NEP does

recognize the need for the redistribution of economic opportunities which is a necessary component of any meaningful change in the present economic system. Reality, however, has already set in, hastened by the exogenous shocks that jolted the country and the threat of a global recession. It is not comforting to observe the government continue vacillating with regard to the design and implementation of appropriate adjustment policies in the face of these rapidly unfolding events.

The next several months would put to an acid test the mettle of the Aquino government. Earlier, reference was made to the possibility that political fragmentation would prove to be the biggest obstacle to economic development. Indeed, if the present crop of leaders do not set aside their petty squabbles and personal ambitions, any worthy reform package would come to naught. This would increase the chances of the outbreak of widespread disturbances and even the risk of a nonconstitutional change in government.

Then again, the present crisis could provide an opportunity for the various factions to settle their differences and instead focus on the problems that beset the country. It would take imaginative, bold, and selfless leadership to achieve political reconciliation and instill a greater deal of rationality in the system. Hopefully, the country does not have to wait until 1992 for this to materialize.

Table 2
ECONOMIC GROWTH AND EMPLOYMENT

	1986	1987	1988	1989	1990 Est.	1991 Proj.	1992 Proj.
Economic growth (Annual growth rate in constant prices, %)							
Agriculture	3.27	(1.02)	3.57	4.29	0.63	2.60	3.17
Industry	(2.08)	7.40	8.97	6.91	2.10	2.21	5.20
Services (Public administration and defense)	2.95	6.63	8.26	5.45	4.04	1.98	3.69
GDP	1.42	4.60	6.37	5.61	2.48	2.22	4.05
GDP and GNP in value terms (In billion pesos)							
In current market prices							
GDP	627.13	708.37	825.85	964.00	1113.61	1318.91	1542.97
National income	490.70	555.52	680.24	794.00	-	-	-
In constant market prices (1972=100)							
GDP	91.18	95.37	101.45	107.14	109.80	112.24	116.78
Employment (Full time equivalent)							
Unemployment rates (%)	22.78	21.40	20.02	19.54	20.43	23.31	24.71
Wages (Index, unskilled labor) (1972=100)	312.65	319.17	379.75	453.97	492.70	573.32	634.87

Table 3
EXPENDITURES ON GDP

	1986	1987	1988	1989	1990 Est.	1991 Proj.	1992 Proj.
(In million domestic currency in current market prices)							
Total consumption	523,432	584,553	676,352	793,561	986,310	1,201,858	1,432,098
Gross capital formation	81,106	113,718	143,256	179,714	203,397	257,207	316,461
Gross fixed capital formation	80,817	101,781	126,413	167,139	206,052	257,207	313,280
Increase in stocks	289	11,937	16,843	12,575	(3,455)		3,181
Exports of goods and services	155,184	163,472	202,936	242,581	281,394	356,886	420,815
(-) Imports of goods and services	116,188	157,397	198,137	253,257	305,153	386,650	448,465
Statistical discrepancy	(16,325)	4,022	1,445	1,398	(56,298)	(110,193)	(174,623)
Gross domestic product	627,129	708,368	825,852	963,997	1,109,650	1,319,108	1,545,486
Net factor income from the rest of the world	(12,426)	(5,007)	(2,982)	(2,621)	3,651	(169)	(2,421)
Gross national product	614,703	703,361	822,870	961,376	1,113,301	1,318,939	1,543,065
(As percent of GDP) at constant prices							
Domestic saving 1/	17.98	16.97	17.15	16.67	13.92	12.20	11.22
National saving 1/	16.14	16.28	16.79	16.37	14.26	12.18	11.05
Gross capital formation	11.89	14.23	15.70	17.06	16.89	16.90	17.04

1/ Domestic saving is defined as GDP minus total consumption, while national saving is defined as GNP minus total consumption.

Table 3A
EXPENDITURE ON GDP

	1986		1987		1988		1989		1990		1991		1992	
	1/	Growth	Levels	Growth	Levels	Growth	Levels	Growth	Levels	Growth	Levels	Growth	Levels	Growth
	Rate	Rate		Rate		Rate		Rate		Rate		Rate		Rate
Total consumption	74,784	(0.79)	79,183	(5.88)	84,055	(6.15)	89,287	(6.22)	94,515	(5.86)	98,543	(4.46)	103,683	(5.22)
Gross capital formation	10,111	(-9.11)	13,574	(34.25)	15,928	(17.33)	18,283	(14.80)	18,543	(1.42)	18,973	(2.32)	19,897	(4.87)
Gross fixed capital formation	10,057	(-14.98)	12,017	(19.49)	13,874	(15.45)	16,863	(21.54)	18,856	(11.83)	18,973	(0.61)	19,897	(3.82)
Increase in stocks	54	(-7.69)	1,557		2,052	(31.79)	1,420	(30.80)	(315)	(-122.18)	0	(-100)	200	(100)
Exports of goods and services	23,560	(21.75)	23,245	(1.34)	26,931	(15.86)	29,167	(8.30)	29,992	(2.83)	31,842	(6.17)	33,758	(6.01)
(-) Imports of goods and services	15,802	(12.91)	19,987	(26.48)	26,670	(33.44)	33,942	(27.27)	38,216	(12.77)	39,077	(2.09)	40,899	(4.66)
Statistical discrepancy	(1,473)	(-6.05)	(844)	(-89.88)	1,208	287.58	4,348	(259.93)	5,021	(23.82)	1,953	(-61.10)	345	(-82.34)
Gross domestic product	91,180	(1.42)	95,371	(4.60)	101,450	(6.37)	107,143	(5.61)	109,797	(2.48)	112,238	(2.22)	116,782	(4.05)
Net factor income from the rest of the world	(1,876)	(-17.72)	(668)	(-60.26)	(357)	(-47.75)	(313)	(12.32)	381	(-221.73)	(17)	(-186.5)	(190)	(-1217.65)
Gross national product	89,504	(1.86)	94,705	(5.81)	101,093	(6.75)	108,830	(5.67)	110,178	(3.13)	112,219	(1.85)	116,592	(3.90)

1/ In million domestic currency at constant market prices.

Table 4
INFLATION, MONEY SUPPLY AND GOVERNMENT BUDGET

	1986	1987	1988	1989	1990 Est.	1991 Proj.	1992 Proj.
1. Inflation							
Consumer prices (1972=100)							
Annual average index	749.61	778.05	846.21	935.89	1055.48	1234.55	1395.57
End month index							
% Change	0.75	3.79	8.76	10.60	12.78	16.97	13.84
Wholesale prices							
Annual average index	992.09	1082.21	1227.49	1359.25	1515.98	1891.32	2198.03
End month index							
2. Money supply (In billion pesos) a/							
M1 (narrowly defined money)	42.66	52.09	59.55	78.53	87.17	100.30	115.25
M2 (broadly defined money)	136.27	155.63	192.41	250.17	294.02	344.10	399.93
3. Government budget (In billion pesos)							
Revenue	79.25	103.21	112.90	152.70	179.13	216.12	244.84
Tax	65.75	85.92	90.36	122.36	143.82	178.50	205.09
Nontax	13.49	17.95	22.54	30.34	35.31	37.62	39.75
Expenditure	113.67	119.47	133.18	172.00	223.90	263.10	294.30
Current	46.95	58.14	66.78	145.20	182.50	203.50	222.20
Development	14.02	17.33	16.27	22.80	33.50	47.70	52.90
Overall surplus/deficit (As a % of GDP)	5.49	2.30	2.46	2.00	4.02	3.56	3.21

a/ Old concept: does not include Land Bank of the Philippines reserve balances.

Table 5
TRADE AND BALANCE OF PAYMENTS
(In US\$ M)

	1986	1987	1988	1989	1990 Est.	1991 Proj.	1992 Proj.
Merchandise: Exports fob	4,842	5,720	7,074	7,821	8,055	8,959	10,213
Merchandise: Imports fob	5,044	6,737	8,159	10,419	12,114	12,811	13,481
Trade balance	(202)	(1,017)	(1,085)	(2,598)	(4,058)	(3,851)	(3,267)
Services and transfers (net)	1,198	573	695	1,133	1,001	1,213	1,125
Other goods, serv. and income, credit	3,791	3,454	3,592	4,586	4,726	5,164	5,550
Other goods, serv. and income, debit	3,034	3,454	3,672	4,283	4,417	4,727	5,133
Private unrequited transfers							
a) Workers' remittances	696	809	874	1,002	1,205	1,385	1,525
Official unrequited transfers							
Current account	996	(444)	(390)	(1,465)	(3,057)	(2,638)	(2,142)
Memorandum items							
Exchange rate (per U.S. dollar: annual ave.)	20.39	20.57	21.10	21.74	24.23	28.50	30.00
Terms of trade	109.60	103.90	157.10	81.90	-	-	-
Unit value index (exports)	116.60	124.20	130.20	155.00	-	-	-
Unit value index (imports)	119.70	150.00	191.30	247.20	-	-	-
(1985=100) period ave.							
Merchandise imports c.i.f.	5394.00	7188.00	8731.00	11171.00	-	-	-

Table 6
EXTERNAL DEBT
(In US\$ B)

	1986	1987	1988	1989	1990 Est.	1991 Proj.	1992 Proj.
External debt outstanding	28.26	28.65	27.92	27.62	28.22	30.58	33.47
Long-term	22.88	24.86	24.15	23.67	22.91	25.26	28.33
Short-term	5.38	3.79	3.76	3.95	4.85	4.89	3.93
Use of IMF credit							
Others							
Debt-service payments 1/	2.94	3.81	3.88	3.13	3.83	3.46	3.81
Principal repayment	1.88	1.89	0.99	0.91	1.78	1.19	1.24
Long-term							
Short-term							
Interest payment on long-term debt	1.94	1.91	2.81	2.22	2.14	2.27	2.57
Debt-service ratio (%) 2/	34.88	32.88	28.28	25.28	38.27	27.75	24.61

1/ After rescheduling

2/ Scheduled payment as a ratio of exports of goods and services.

Table 7
FINANCIAL FLOWS 1/
(Net Receipt Basis)

	1986	1987	1988	1989	1990 Est.	1991 Proj.	1992 Proj.
Official flows	1,131.9	1,073.7	1,254.8				
Official development assistance (ODA)	955.8	770.2	854.3				
Grant	516.0	461.2	402.6				
Loans	439.9	309.0	451.7				
Other official flows	176.1	303.5	400.5				
Private flows	(40.1)	(225.6)	36.0				
Direct investment	60.2	77.7	194.4				
Portfolio investment	188.5	(169)	17.2				
Export credit	(288.8)	(134.3)	(207.9)				
Total receipts (net)	1,091.8	848.1	1,258.4				
Memorandum items							
ODA commitments	1,103.1	1,074.1	1,870.4				

1/ OECD, Geographical Distribution of Financial Flows to Developing Countries, July 1990.

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